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DCI Interagency Balkan Task Force

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**Grim Outlook for Croatia's Divided Economy**

*The occupation of one-quarter of Croatia's territory by separatist Serbs has disrupted the country's economy significantly, but not critically. Croatia proper (Croatia) and the self-proclaimed Serb occupied areas of the "Republic of Serb Krajina" (RSK) both would benefit from renewed economic cooperation, which would allow them to restore transportation links and repair infrastructure, if political differences could be resolved. Barring a settlement, Zagreb will remain cut off from economically important areas such as UN Sector East, and the RSK will remain an economic backwater reliant on meager and uncertain financial support from Serbia and Bosnian Serb areas.*

**War Hurt Both Sides**

Both Croatia and the RSK have suffered economically as a result of the outbreak of fighting in 1991.

- Major transportation connections to the Dalmatian coast were severed.
- Croatia has lost access to oilfields and important agricultural regions mainly in UN Sector East.
- The Krajina, in turn, has been cut off from direct trade with the outside world, instead depending on Serbia to support UN Sector East and on Serbian supply lines through Serb-held northern Bosnia to provide goods to UN Sectors North and South, and, until recently, UN Sector West.

**Croatian Losses Relatively Light****Land and Natural Resources**

The greatest economic losses to Croatia were in UN Sector East, including the agricultural areas in the east Slavonian plains and the oilfields near Vinkovci.

- Serb occupation of some 20 percent of its farmland has reduced Croatia's near self-sufficiency in agriculture. Grain production was still down 26 percent last year, according to Croatian Government statistics and the US agricultural attaché, although high support prices for wheat have helped revive output and exports.

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- Sizable losses of livestock also occurred during the 1991 fighting, resulting in a 28-percent decline in the numbers of cattle, hogs, and sheep and a 23-percent fall in poultry numbers compared to average prewar levels.
- The Krajina Serbs reportedly draw about 3,000 barrels per day--about 10 percent of total Croatian production--from three captured oil wells at Djeletovci, Prilaka, and Ilaca. However, Croatia still controls the most significant oil reserves along the Hungarian border. [ ]

Loss of the barite mines in UN Sectors North and South and bauxite deposits near Drnis and Obrovac in UN Sector South was much less significant.

- Nonferrous ore mining contributed less than one percent to Croatia's national income in 1991 prior to the war. [ ]

### Infrastructure

Intermittent fighting has substantially disrupted Croatia's power industry. The Adria pipeline connecting the Omisalj oil terminal on the Adriatic to the Sisak refinery has been cut off in UN Sector North almost continually since September 1991. Croatia has managed to largely compensate by increasing reliance on its largest refinery at Rijeka and by importing some Russian oil via the Friendship pipeline through Hungary. The Adria pipeline was used before the war to export oil to Hungary, Czechoslovakia, and other refineries in the former Yugoslavia. [ ]

Croatia also has lost the use of three of five hydroelectric plants located along the Dalmatian coast.

- The plant at Obrovac in UN Sector South has fallen under Krajina Serb control, while the plants at Zakucac and Orlovac have been disconnected from the Croatian electrical grid as a result of fighting.
- The loss of these plants, in conjunction with the severing of the primary 400-kilovolt line connecting the southern Dalmatian coast with the power grids in northern Croatia and Bosnia in 1992, has left southern Dalmatia dependent on power from Dubrovnik and smaller gas and diesel generators brought into several coastal cities in 1993. [ ]

Croatia has lost the industrial towns of Vukovar, Borovo, and Beli Manistir in UN Sector East, Petrinja and Kostajnica in UN Sector North, and Knin in UN Sector South. These towns manufactured mainly timber products, processed food, textiles, and leather goods. Small-scale metal processing also took place in Knin.

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[redacted]

- These industries taken in their entirety constituted only about 14 percent of Croatia's national income in 1991, and generated roughly 15 percent of export revenue equal to about \$500 million. [redacted]

### Transportation

The key transportation links disrupted by the conflict include the Zagreb-Belgrade highway and rail line, which connected Zagreb and points west with Croatia's main agricultural areas and oilfields in eastern Slavonia. Despite Zagreb's recent recapture of UN Sector West, traffic along the highway and rail lines could still be disrupted by artillery fire from Bosnian Serb-held Bosanski Brod across the border. [redacted]

Croatia also has lost its rail links to the Dalmatian ports of Zadar and Split, which run through the railway hub in Knin in UN Sector South. This not only has hindered Croatia's ability to deliver goods to areas along the coast but has substantially curtailed tourist traffic. The Krajina Serbs also can disrupt traffic along the Dalmatian coastal highway by shelling the Maslenica area just northeast of Zadar, while Bosnian Serbs can shell Dubrovnik airport. [redacted]

### Tourism and Foreign Investment

Before the war Croatia earned nearly \$3 billion annually from tourism generated from the Istria peninsula and along the rest of the Dalmatian coast. Despite the conflict, revenue from tourism in the Istrian area, away from the conflict, reportedly reached \$1.3 billion in 1994, equal to nearly 10 percent of Croatia's GDP that year. Tourism is likely to contract sharply given growing prospects for renewed fighting.

- Croatia's continuing need to house around 75,000 refugees in many of the country's tourist facilities also will preclude a full recovery until a lasting peace allows for the relocation of displaced persons. [redacted]

Croatia's continued political uncertainty has also discouraged foreign investment. Direct investment declined from \$448 million in 1992 to \$298 million in 1994, according to press reports, and is expected to fall further if fighting escalates. [redacted]

### Krajina's Tenuous Economic Survival

The Krajina has become even more of an economic backwater since the war. Fighting has cut off its outdated labor-intensive industries from traditional markets in Croatia, causing economic conditions to rapidly deteriorate. [redacted]

- Industrial production may be down by as much as 80 percent overall from prewar levels, according to an RSK official. Even industry in UN Sector East, which benefits from access to markets in Serbia, operates at only 20 percent of capacity [redacted]

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- Unemployment has reached between 60 percent and 75 percent, [redacted] UN Sector East leads this grim statistic with unemployment between 80 percent and 90 percent despite its higher industrial production [redacted]  
[redacted]

The Krajina has suffered a massive drop in living standards. Economic conditions have been made worse by the need to redirect remaining exports from Croatia to the much weaker markets of Serbia and the Bosnian Serb-held areas, cutting export earnings, and by the higher prices charged for smuggled imports.

- The RSK economy has also suffered from the loss of pension payments from both Zagreb and Belgrade. [redacted]

Although consumer goods and medicines are reportedly scarce in the Krajina, there is no evidence of widespread hunger. RSK farms still produce enough to feed the local populace, according to diplomatic and press reporting. Unlike Zagreb, however, the RSK has been unable to repair much of its war damage, according to the US Embassy. [redacted]

### **Political Realities Bode Ill for Economic Cooperation**

Three scenarios should be considered for Croatia's economic outlook over the next two years. In the worst case, wide-scale Croatian military action in UN Sectors North and South could escalate and drag on for months. This would forestall any economic cooperation between the two adversaries, and potentially damage several Croatian industrial centers. Renewal of economic and confidence-building measures and a credible lasting cessation of hostilities would present the best economic prospects for both parties. [redacted]

### **Fighting Resumes**

Wide-scale fighting could have serious consequences for both sides, particularly Croatia. Although most Croatian industries have escaped damage up to now, many cities remain within range of Serb artillery. If Zagreb were to try to retake additional territory, the RSK could retaliate with an all-out assault on Croatia's industrial base. Primary industrial targets include the cities of Zagreb, Karlovac, Zadar, Split, Dubrovnik, and Osijek, as well as such important facilities as the Peruca Dam and Maslenica (pontoon) bridge. Along with the material damage, tourism revenue and foreign investment would plunge. [redacted]

A growing military budget and falling tax revenues would force Zagreb to forego the limited progress it has made on economic reforms, such as privatization and restructuring the banking sector. Zagreb would also have to abandon the tight monetary and fiscal policies that have been crucial in curbing inflation and attracting funding from the IMF and World Bank.

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- International Financial Institution funding is likely to be suspended in any case if fighting is protracted, particularly if Zagreb is perceived to be responsible for the conflict. [redacted]

Even in the worst-case scenario, it is unlikely that Zagreb would try to retake UN Sector East, the only economically significant piece of Serb-occupied territory, in the near term. Zagreb is aware that Serbia would intervene directly to prevent its loss. [redacted]

#### Status Quo Portends RSK Stagnation

Croatia's recapture of UN Sector West will have limited economic consequences for either side. Croatia has regained the major route to the agricultural and mineral resources of eastern Slavonia via the Zagreb-Belgrade highway and railway, which should improve supplies and reduce prices of domestically produced agricultural goods and crude petroleum. Without a peace settlement, this benefit could be short-lived because of the highway's vulnerability to Bosnian Serb shelling. [redacted]

Zagreb will eventually have to make large expenditures to build transportation, communication, and power linkages around Serb-held areas to reintegrate Dalmatia into the Croatian economy. Continued political uncertainty is likely to dampen the revival of the tourist industry and scare off most foreign investors. [redacted]

While the RSK has lost a major political bargaining chip, UN Sector West has little economic significance. The Krajina Serbs have lost some agricultural land--mainly a grain-growing area--and a construction materials plant in Okucani, the sector's only significant industry. [redacted]

The RSK's overall economic prospects probably will deteriorate under current conditions, even in the absence of additional fighting. Trade with Serbia and the Bosnian Serbs is likely to continue falling as those two areas face increasing financial constraints from UN sanctions.

- According to the press, emigration of educated and young people has significantly increased since Croatia recaptured UN Sector West. [redacted]

#### Renewed Cooperation

Renewed cooperation, particularly reestablishing transportation links and restoring various utilities, would provide the most advantage to both parties if political differences are resolved. Zagreb would greatly benefit from secure access to road, rail and air links with Dalmatia and the boost this would give its tourist industry. The energy situation would also be greatly improved by renewed cooperation that includes reopening the Adria pipeline, restoring power lines from northern Croatia to the Dalmatian coast, reconnecting the Zakucac and Orlovac plants to the Croatian grid, and buying hydroelectricity from the Serb-controlled Obrovac hydroelectric plant. Croatia would achieve substantial savings if it could close its less-efficient oil-fired plants. [redacted]

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The Krajina would gain even more from a resumption of economic ties with Croatia, but it would want to preserve its political independence. Resuming trade with traditional markets in Croatia and abroad would greatly increase its current export potential. Moreover, the RSK would no longer have to pay a premium to smuggle imports through Bosnian Serb territory.

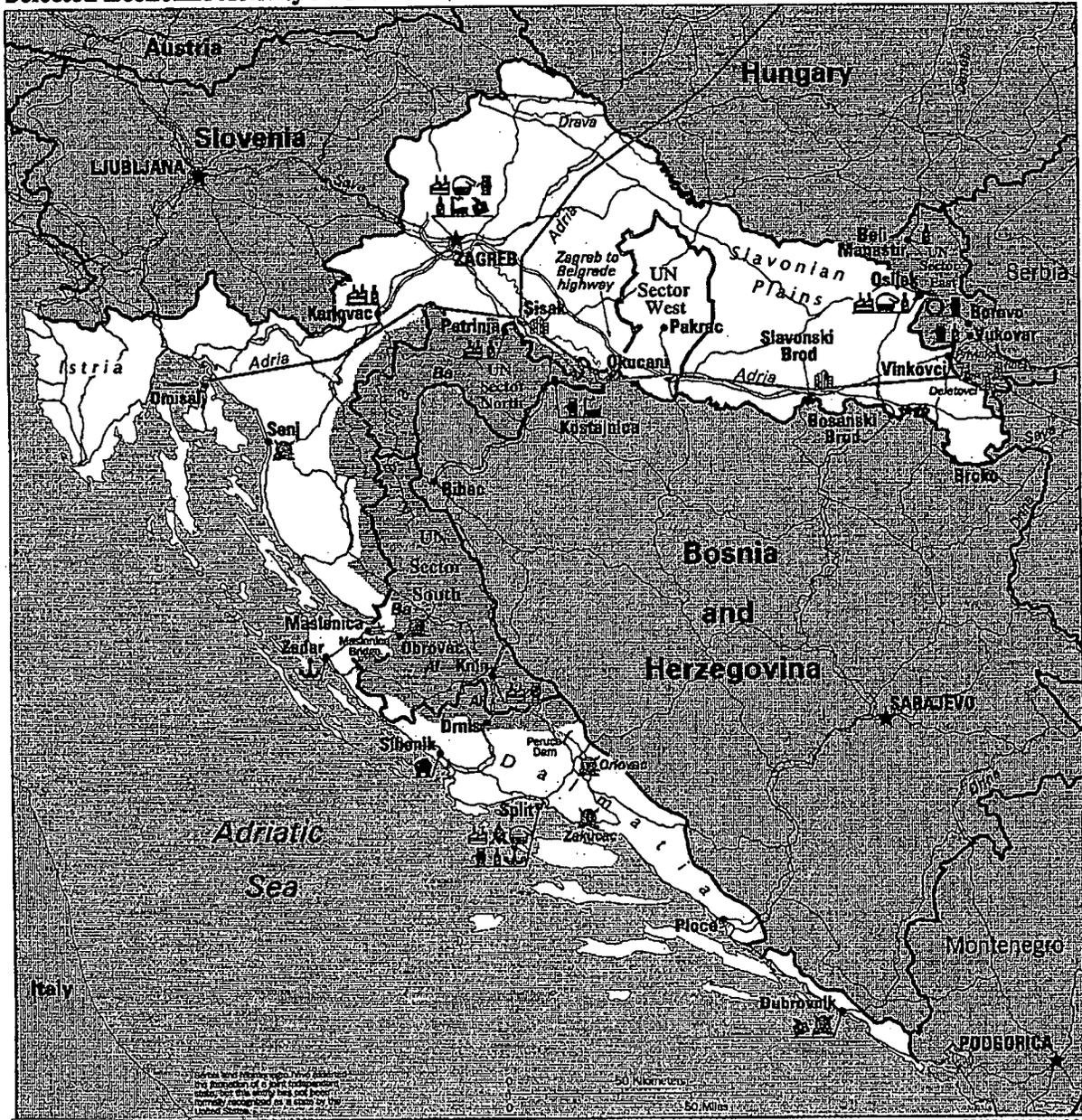
- The RSK could also benefit from the rapid resumption of pension payments proposed by Zagreb, according to a reliable source. Zagreb has already begun paying pensions to Serbs in Pakrac in UN Sector West, according to the US Embassy. (S NF)

### Outlook

Zagreb is unlikely to seriously pursue a resumption of economic ties absent a political settlement reintegrating the Krajina into Croatia. It remains concerned that any measures that shore up the RSK's economy will also harden Knin's resolve to hold out for complete independence. As a result, Croatia is likely to continue military offensives to recapture Serb-held areas if it decides diplomacy is not working and it feels it can accomplish this quickly and decisively. Zagreb probably believes that a rapid reconquest would minimize political fallout and hence the possible disruption of international financing and investment. It also believes that complete restoration of control over vital transportation links is the only way to restore Croatia's economic potential. [redacted]

Zagreb will try to avoid a protracted conflict, fearing not only the possibility of more damage to its infrastructure, but also cementing foreign perceptions of an unstable economic environment. In the worst-case scenario, Zagreb probably still fears the imposition of international sanctions if it cannot achieve a quick military victory and allows the international community time to deliberate. [redacted]

**Selected Economic Activity in Croatia**



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Industry		Energy	
Metallurgy	Barite mining	Hydroelectric plant	Serb-controlled area in Croatia
Heavy Industry (machinery, metal goods, and building materials)	Bauxite mining	Oil pipeline	UN sector boundary
Shipbuilding	Rubber products	Oil refinery	Port
Chemicals	Textiles (yam, fabric, clothing, and footwear)	Oil terminal	Railroad
	Food processing	Oil well	Road
	Light Industry (wood, paper, glass, and ceramics)		
	Tourism		